83-768

Office-Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

October Term, 1983

ST. FRANCIS HOSPITAL CENTER, ET AL.,*

Petitioners,

vs.

MARGARET HECKLER, Secretary, Department of Health and Human Services and PROVIDER REIMBURSEMENT AND REVIEW BOARD, THOMAS TIERNEY, Chairman,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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THE METHODIST HOSPITAL OF GARY, INC.
ST. ELIZABETH HOSPITAL MEDICAL CENTER
ST. MARGARET HOSPITAL,
HENDRICKS COUNTY HOSPITAL,
LaPORTE HOSPITAL,
HOWARD COMMUNITY HOSPITAL,
ST. CATHERINE HOSPITAL OF EAST CHICAGO, INDIANA, INC.,
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COMMUNITY HOSPITAL OF ANDERSON AND MADISON COUNTY, INC.,
BLACKFORD COUNTY HOSPITAL,
BROADWAY METHODIST HOSPITAL

Petitioners

QUESTION PRESENTED

Whether the Seventh Circuit erred in holding that the Petitioners forfeited their Fifth Amendment guarantee against the federal government setting confiscatory rates because they "voluntarily" provided services to patients covered under the Medicare program?

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OPINION BELOW

The opinion of the Court of Appeals, not yet reported, appears in the Appendix hereto. The opinion of the District Court, reported at 544 F. Supp. 1167 (S.D. Ind. 1982) is also reproduced in the Appendix.

JURISDICTION

The judgment of the Court of Appeals for the Seventh Circuit was entered on August 12, 1983. This petition for certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

PERTINENT STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED

UNITED STATES CONSTITUTION, AMENDMENT V—CAPITAL CRIMES; DOUBLE JEOPARDY; SELF-INCRIMINATION; DUE PROCESS; JUST COMPENSATION FOR PROPERTY:

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall be private property be taken for public use, without just compensation.

UNITED STATES CODE, TITLE 42, § 1395x(v)(1)(A):

The reasonable cost of any services shall be the cost actually incurred, excluding therefrom any part of incurred cost found to be unnecessary in the efficient delivery of needed health services, and shall be determined in accordance with regulations establishing the method or methods to be used, and the items to be included, in determining such costs for various types or classes of institutions, agencies, and services; except that in any case to which paragraph (2) or (3) applies, the amount of the payment determined under such paragraph with respect to

the services involved shall be considered the reasonable cost of such services. In prescribing the regulations referred to in the preceding sentence, the Secretary shall consider, among other things, the principles generally applied by national organizations or established prepayment organizations (which have developed such principles) in computing the amount of payment, to be made by persons other than the recipients of services, to providers of services on account of services furnished to such recipients by such providers. Such regulations may provide for determination of the costs of services on a per diem, per unit, per capita, or other basis, may provide for using different methods in different circumstances, may provide for the use of estimates of costs of particular items or services, may provide for the establishment of limits on the direct or indirect overall incurred costs or incurred costs of specific items or services or groups of items or services to be recognized as reasonable based on estimates of the costs necessary in the efficient delivery of needed health services to individuals covered by the insurance programs established under this subchapter, and may provide for the use of charges or a percentage of charges where this method reasonably reflects the costs. Such regulations shall (i) take into account both direct and indirect costs of providers of services (excluding therefrom any such costs, including standby costs, which are determined in accordance with regulations to be unnecessary in the efficient delivery of services covered by the insurance programs established under this subchapter) in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this subchapter will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs, and (ii) provide for the making of suitable retroactive corrective adjustments where, for a provider of services for

any fiscal period, the aggregate reimbursement produced by the methods of determining costs proves to be either inadequate or excessive.

STATEMENT OF THE CASE

Petitioners are 68 nonproprietary Indiana hospitals that have sought payment for a return on net assets (also referred to in the record as a "return on equity") used by them in rendering services to Medicare patients during their respective fiscal years ending in 1977 or 1978 pursuant to the Health Insurance for the Aged and Disabled Act, Sections 1801, *et seq.*, of the Social Security Act, 42 U.S.C. § 1395, *et seq.*, as amended (the "Medicare Act"). The fiscal intermediary denied payment to Petitioners for any such return as claimed in their timely filed costs reports. Petitioners timely filed appeals from such disallowance with the Provider Reimbursement Review Board ('PRRB") which, after a full hearing, unanimously upheld the Petitioners' claim for a return on the net assets used in treating Medicare patients, finding that without such a return "all not-for-profit hospitals are forced to pass on the nonrecognized indirect costs of return on equity capital to other paying patients".

The Deputy Administrator of the Health Care Financing Administration, to whom the Secretary of Health and Human Services has delegated the authority to review PRRB decisions, reversed the PRRB's decision as to payment for a return on equity and the Petitioners appealed such action to the District Court for the Southern District of Indiana ("District Court"). The jurisdiction of the District Court was invoked under 42 U.S.C. § 1395oo(f)(1). On cross motions for summary judgment the District Court granted the Secretary's motion and affirmed the Deputy Administrator's decision. The District Court held, *inter alia*, that while the "utilities cases" (*Smyth v. Ames*, 169 U.S. 466, *modified*, 171 U.S. 361

(1898) and its progeny) were analogous to the within action, "important distinctions" prevented the application of the just compensation clause of the Fifth Amendment to the present case. The District Court concluded that because Petitioners voluntarily participated in the Medicare program no just compensation issue was presented.

Petitioners appealed to the United States Court of Appeals for the Seventh Circuit which affirmed the decision of the District Court. The Court of Appeals, in rejecting Petitioners' claims for a return on their equity under the just compensation provision of the Fifth Amendment, held that while a claim to such entitlement under *Smyth* and its progeny "might well prove persuasive if participation in the Medicare program were mandatory", participation is voluntary.[1]

REASON FOR GRANTING THE WRIT

THE DECISION BELOW DIRECTLY CONFLICTS WITH THIS COURT'S OPINION IN *BANTON V. BELT LINE RAILWAY CORP.*[2] AND OTHER DECISIONS OF THIS COURT BY DENYING FIFTH AMENDMENT JUST COMPENSATION PROTECTION TO PETITIONERS BECAUSE THEY VOLUNTARILY PROVIDED SERVICES TO MEDICARE PATIENTS COVERED UNDER THE MEDICARE PROGRAM.

Under the just compensation clause of the Fifth Amendment to the United States Constitution, the federal

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[1] It is assumed for purposes of this Petition only that the Petitioners' choice as to whether to participate in the Medicare program was other than mandatory. This assumption, however, ignores: (1) the practical economic and social pressures placed on nonproprietary hospitals to serve the needs of all members of society and not just those persons under age sixty-five, (2) the dependence of the Medicare program on participation by nonproprietary hospitals, and (3) that as recipients of grants under the Hill-Burton Act [42 U.S.C. § 291] the Hospitals *must* participate in the Medicare and Medicaid programs. *See* 42 C.F.R. § 53.111; 42 C.F.R. § 124 *et seq.*

[2] 268 U.S. 413 (1925).

government may fix prices or set rates for services rendered to the public only if such prices or rates provide compensation sufficient to yield a nonconfiscatory rate of return on the value of the private property used to provide such services.[3] In other words, when the government regulates prices by setting maximum rates to be charged by those providing services to the public, the prescribed rates may not be set so low as to become confiscatory. *Smyth v. Ames*, 169 U.S. 466, 526, *modified*, 171 U.S. 361 (1898). The Medicare reimbursement scheme as applied to Petitioners for the cost years in issue must be examined in light of this constitutional check on the government's power to set rates.[4]

The Court of Appeals below explicitly acknowledged the basic principle of *Smyth v. Ames;* however, it denied Petitioners' request for relief on the ground that valid

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[3] *See Denver Union Stockyard Co. v. United States*, 304 U.S. 470 (1938); *United Railways & Electric Co. of Baltimore v. West*, 280 U.S. 234 (1930) (a return of 6.26% "clearly inadequate"); *McCardle v. Indianapolis Water Co.*, 272 U.S. 400 (1926); *Public Utility Commissioners v. New York Telephone Co.*, 271 U.S. 23 (1925); *Bluefield Waterworks and Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923) (a return of 6% "substantially too low"); *Denver v. Denver Union Water Co.*, 246 U.S. 178 (1918) (a return of 4.2812% "clearly inadequate"); *Minnesota Rate Cases (Simpson v. Shepard)* 230 U.S. 352 (1913); *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Smyth v. Ames*, 169 U.S. 469, *modified*, 171 U.S. 361 (1898). (Note that under the Medicare program, Petitioners receive 0% return on the value of property used in treating Medicare patients.)

The constitutional analysis applied to a just compensation challenge against a *state* regulatory scheme under the Fourteenth Amendment due process clause is the same analysis applicable to a challenge against a *federal* regulatory scheme made under the Fifth Amendment just compensation clause. *See Denver Union Stockyard Co. v. United States*, 304 U.S. 470 (1938); *Smyth v. Ames*, 169 U.S. 466, *modified*, 171 U.S. 361 (1898).

[4] From the Petitioners perspective, the limited "reasonable cost" reimbursement under the Medicare Act for services provided Medicare patients is nothing more than price-fixing. Regardless of who pays the bills, the practical effect of the Medicare program is that a maximum recoverable amount for services rendered is determined by a regulatory body.

assertion of the Fifth Amendment protection is predicated on mandatory participation in the Medicare program and since Petitioners voluntarily participated, there was no violation of the Fifth Amendment.[5] Thus the sole and narrow issue raised by the opinions of the District Court and Court of Appeals below and as set forth by this Petition is whether the voluntary or involuntary nature of Petitioners' participation in the Medicare program is relevant in determining Petitioners' constitutional rights under the Fifth Amendment.

The Seventh Circuit's decision that Petitioners surrendered their constitutional right to just compensation by voluntarily participating in the Medicare program *directly conflicts* with this Court's holding in *Banton v. Belt Line Railway Corp.*, 268 U.S. 413 (1925). In *Banton*, Belt Line Railway ("Belt Line") sought to enjoin enforcement of an order issued in 1912 by the New York City Public Service Commission ("Commission") establishing joint routes on street railways in New York City and a joint maximum fare of 5 cents to be charged on those routes. Belt Line operated a street railway forming a portion of the designated routes and was entitled to 2 cents as its portion of the joint fare. Belt Line was incorporated after the order was issued by one Cornell, who contributed to Belt Line all the property, rights and franchises of the Central Park Company (the "predecessor") which he had previously purchased at a foreclosure sale. Pursuant to New York law,

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[5] *See* Court of Appeals opinion below, No. 82-2458, at 6-7. The Court of Appeals and District Court below cite *Pharmacist Political Action Committee v. Harris*, 502 F. Supp. 1235 (D. Md. 1980) and *Hempstead General Hospital v. Whalen*, 474 F. Supp. 398 (E.D.N.Y. 1979), *aff'd without opinion*, 622 F.2d 573 (2d Cir. 1980), respectively, to support the notion that voluntary participation in the Medicare Program results in a surrender of Fifth Amendment rights. Both *Pharmacist* and *Hempstead* boldly assert this proposition without citation to any applicable decision of this Court. The *Pharmacist* decision cites no supporting precedent, while the *Hempstead* case cites inapplicable eminent domain cases indicative of that court's failure to distinguish between condemnation cases versus regulatory taking cases.

Belt Line assumed in addition to the rights, privileges and franchises of the predecessor, all the provisions, duties and liabilities imposed by law on the predecessor. In support of its request for an injunction, Belt Line alleged that the prescribed fare deprived it of any return on the value of its property used to perform the service and thus the Commission's order violated, *inter alia*, the due process clause of the Fourteenth Amendment.

Insisting that its order should not have been enjoined by the district court, the Commission argued that Belt Line

> *voluntarily* assumed the obligation to carry transfer passengers pursuant to the order of October 29, 1912, for 2 cents each; and having been incorporated and having acquired its property subsequent and subject to such order, it is not entitled to complain of the order as an infringement of any constitutional right.

268 U.S. at 417-18 (emphasis supplied).

This Court flatly rejected the Commission's voluntariness argument. The Court reasoned that while Belt Line's predecessor "accepted the order, and put in effect the prescribed fare of 5 cents," which it was bound by law to do if it chose to continue to service the designated routes,

> [a] rate that is just and reasonable when prescribed subsequently may become too low, unreasonable, and confiscatory. [Citations omitted.] [The predecessor] did not agree to serve for the prescribed fare of 5 cents, and was not bound to do so *if the rate was found to be, or thereafter it should become, confiscatory. It did not surrender the protection of the 14th Amendment.*

Id. at 418 (emphasis supplied).

The essence of this Court's decision in *Banton* is that the voluntary provision of services in a market where rates are fixed by the government *does not amount to an agreement to provide services at a governmentally prescribed rate if that rate is or should become constitutionally confiscatory.*

Voluntary participation in a market where rates have been fixed by the government does not surrender constitutional protection against the government setting confiscatory rates.

The Petitioners find themselves in the same position as the railway company in *Banton*. After the Medicare Act was passed in 1965, Petitioners participated in the Medicare program, assuming the obligation to provide healthcare services to Medicare patients pursuant to the rates of reimbursement provided by the Medicare Act. Initially, Petitioners were paid to a two percent allowance under the Medicare Act that admittedly included a portion allocable to a return on net assets.[6] With payment of this allowance, there was at least arguably "just compensation" in the constitutional sense. However, the repeal of the allowance in 1969 by the Secretary of the Department of Health, Education and Welfare removed this last vestige of constitutionality with respect to nonproprietary hospitals.[7] Just as the railway company in *Banton* did not agree to be bound by the joint fare of 5 cents if it became confiscatory, *Petitioners did not agree to serve at the prescribed Medicare rate of reimbursement if it is found to be confiscatory by reason of the failure to provide for a return on net assets.*

The courts below rely heavily on the observations that Petitioners were still free to serve non Medicare patients[8] or

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[6] *See* District Court opinion below, 544 F. Supp. at 1176 (Appendix hereto at A-53).

[7] In a recent related federal case, the repeal of the two percent allowance was successfully challenged as a violation of the notice, public procedure and effective date requirements of the Administrative Procedure Act (5 U.S.C. §553). *See Baylor University Medical Center v. Schweiker*, No. 3-82-0986-H, slip op. (N.D. Tex. Sept. 13, 1983) (reproduced in the Appendix hereto). While the *issues* addressed in *Baylor* are unrelated to that raised by this Petition, the ultimate outcome of that case would no doubt be affected by these proceedings should the plaintiff in *Baylor* assert in any subsequent administrative hearing that the repeal of the two percent allowance violates the Fifth Amendment.

[8] Court of Appeals opinion below, No. 82-2458, at 6-7 (Appendix hereto at A-7).

sell their physical plants[9] if they opted not to participate in Medicare. While these observations may be accurate, they are irrelevant under this Court's holding in *Banton*. The railway company in *Banton* was free to divert traffic from routes where the prescribed rates resulted in confiscation to those where it did not, *see Banton*, 268 U.S. at 417, and was also free to sell its assets[10]. However, these possibilities did not alter the Court's holding that Belt Line did not surrender its constitutional right to just compensation. Thus, under the principle established in *Banton*, the voluntary or involuntary nature of Petitioners' participation in the Medicare program is irrelevant in determining whether the rate of reimbursement established under the Medicare Act is unconstitutionally confiscatory.

This Court's decision in *Banton* explicitly recognized what was implicit in an unbroken chain of this Court's decisions concerning government rate setting. *See Smyth v. Ames*, 169 U.S. 466 (1898) (the only decision of this Court cited by the Court of Appeals below); *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Denver v. Denver Union Water Co.*, 246 U.S. 178 (1918); *Bluefield Waterworks and Improvement Co. v. Public Service Comm'n.*, 262 U.S. 679 (1923); *Public Utility Commr's v. New York Telephone Co.*, 271 U.S. 23 (1925); *Denver Union Stock Yard Co. v. United States*, 304 U.S. 470 (1938). In each of these decisions, the party affected by the government rate setting could have withdrawn its property from the regulated activities and either put it to nonregulated uses or sold the property.

The regulatory scheme presented in *Smyth v. Ames*, for example, is so analogous to the Medicare reimbursement scheme presented to this Court that the general principles

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[9] *Id.* at 24 (Appendix hereto at A-26).

[10] This may not have been practical, however, according to the Court of Appeals below, practical realities are irrelevant. *See id.* at 7 (Appendix hereto at A-7).

enunciated in *Smyth* are not only helpful in resolving the issue raised by this Petition, but are controlling.[11] In *Smyth* the constitutionality of a Nebraska statute setting maximum rates to be charged for the *intrastate* transportation of freights was challenged by a number of affected railroad companies. The companies claimed that the statute set intrastate rates so low as to become confiscatory and thus violated the Fourteenth Amendment requirement that just compensation be provided for the value of private property used for public purposes. The intrastate activities of some of the railroad companies affected by the rate-setting statute constituted on the average less than five percent of total revenue-producing transportation activities. 169 U.S. at 542-3. One argument on behalf of the state, as interpreted by the Court, was that the state could effectively set *intrastate* rates at any level, even if it meant forcing a railroad company to operate at a loss on local freight business, as long as the railroad company could earn enough on its *interstate* freight business to give it just compensation with respect to its entire line, interstate and intrastate. *Id.* at 541. The Court flatly rejected this argument:

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[11] The District Court below incorrectly determined that *Smyth* and its progeny are inapposite. The court quoted out of context a portion of the opinion in *Smyth* for the proposition that to constitute an unconstitutional taking, there must first be "practical destruction" of the property involved. This particular language was used in *Smyth* to state the proposition that *when* "practical destruction" of property occurs as a result of rates set so low as to deny a fair rate of return on the value of property used, an unconstitutional taking has occurred. However, the Court did not set out as a requirement for just compensation "practical destruction" of the property. In addition, the District Court below failed to properly distinguish between eminent domain cases and taking-regulation cases as evidenced by the citation of and quote from *Hempstead General Hospital v. Whalen*, 474 F.Supp. 398 (E.D.N.Y. 1979), *aff'd without opinion*, 622 F.2d 573 (2d Cir. 1980) which in turn was based upon standards applicable in eminent domain cases such as *Chacon v. Granata*, 515 F.2d 922 (5th Cir. 1975).

> So far as rates for transportation are concerned, domestic [intrastate] business should not be made to bear the losses on interstate business, nor the latter the losses on domestic [intrastate] business.

Id. Bringing the analogy to bear with respect the present case, the basic principle above quoted was embodied by Congress in the Medicare Act in the form of the prohibition against the cross-subsidization between Medicare and nonMedicare patients of the costs of providing healthcare services. The Medicare Act provides:

> "Such regulations [setting the maximum rate of reasonable cost reimbursement] shall (i) take into account both direct and indirect costs of providers of services...in order that, under the methods of determining costs, the necessary costs of efficiently delivering covered services to individuals covered by the insurance programs established by this subchapter [Medicare] will not be borne by individuals not so covered, and the costs with respect to individuals not so covered will not be borne by such insurance programs,...."

42 U.S.C. § 1395(x)(v)(1)(A).

The Court in *Smyth* went on to state:

> It is only rates for the transportation of persons and property between points within the state that the state can prescribe; and when it undertakes to prescribe rates not to be exceeded by the carrier, it must do so with reference *exclusively* to what is just and reasonable, as between the carrier and the public, in respect of domestic [intrastate] business.

169 U.S. at 541 (emphasis supplied). Lack of mandatory participation by the railroads in the intrastate railroad business did not prevent this Court from concluding that the prescribed rates were confiscatory and thus unconstitutional. Thus, in determining whether the rate of reimbursement provided Petitioners under the Medicare Act was unconstitutionally confiscatory, the Court of

Appeals below should have done so with reference *exclusively* to what is just and reasonable.

Twenty years after the *Smyth* decision, the Court again implicitly rejected the proposition that voluntary participation in a market where rates are governmentally fixed forfeits constitutional protection. *See Denver v. Denver Union Water Co.*, 246 U.S. 178 (1918). In *Denver Union Water*, the issue arose with respect to the proper valuation of a water plant held by the Denver Union Water Company upon which a just rate of return was to be allowed. The City of Denver argued that since the water company occupied the streets and performed services for the city merely at the sufferance of the city, the company's property should be valued at its "junk value." 246 U.S. at 184. The Court noted that a necessary corollary of this relationship was that the company could discontinue water service at will. *Id.*

Although rejecting the argument that the company performed its services at sufferance on factual grounds, the Court addressed the voluntariness issue and its effect on property valuation for ratesetting purposes:

> Nor is the question of value for present purposes greatly effected, if at all, by the fact that there is *neither the right nor obligation to continue the use perpetually*.... The reason is not obscure: the cost and detriment to a property owner attributable to the use of his property by the public, and the value of the service rendered by the property to the public, are measured day by day, month by month, year by year, and are little influenced by the question of how long the service is to continue.

Id. at 191 (emphasis added). Thus the key to defining the scope of Fifth Amendment protection is the value of services rendered to the public, *not* whether the service is compelled or voluntary. In either case, rates may not be fixed by government so as to preclude payment of a fair return on equity without being constitutionally confiscatory.

The constitutional implications of the decision below, if left to stand, are particularly disturbing. The Court of Appeals' holding that voluntary participation in a market where rates are governmentally fixed forfeits the constitutional right to just compensation leads to the logical conclusion that if the government prescribes rates for any service rendered to the public, the government is free to prescribe *any* rate it pleases so long as provision of the service can be characterized as "voluntary". In effect, the decision below creates an exception swallowing the constitutional protection itself.

This Court has thus both directly and implicitly addressed the voluntariness issue and rejected it's relevance. The reliance by the Court of Appeals below on voluntary participation as grounds for affirming the District Court's opinion is misplaced and contrary to longstanding precedent of this Court. Thus, it is respectfully requested that this Court address this issue and correct the error in Fifth Amendment analysis by reversing the decision below and remanding the case to the District Court for relief consistent with this Court's decision.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Seventh Circuit Court of Appeals.

Respectfully submitted,

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